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IN THE

Supreme Court of the United States

OCTOBER TERM, 1932.

No. 466.

ESTHER JACKSON PORTER, as Executrix, and RICHARD L. DAVISSON, as Surviving Executor, of the Will of WILLIAM H. PORTER, Deceased,

Petitioners,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR THE PETITIONERS.

WALTER E. HOPE,
Attorney for the Petitioners.

RICHARD L. DAVISSON,
EDWARD N. PERKINS,
Of Counsel.

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REPLY BRIEF FOR THE PETITIONERS.

I.

The contention that, if the exercise of a power may be taxed, the failure to exercise it may be taxed, is not logical and is not supported by the authorities.

The argument starts with the assumption that the decedent had "a general power to appoint by will." In point of fact, the power was *limited* so that the decedent and his estate could not benefit by it. The trust deed, moreover, specifically provides that any alteration shall be made—

> "by instrument in writing executed and acknowledged or proved by him in the manner required for a deed of real estate (so as to enable such deed to

> be recorded in the State of New York) delivered to the Trustee", etc.

The unusual care with which the instrument of alteration is described, including the requirement of acknowledgment, is hardly consistent with the exercise of the power by will and clearly contemplates action by the decedent during his lifetime.

It is to be noted in passing that the Act imposes no tax upon a power but only upon the *exercise* of a *general* power. Section 302 (f) of the Revenue Act of 1926. It is not laid on the failure to exercise the power.

The Government states at p. 14 of its brief—

> "If the exercise of a power may be taxed the failure to exercise it is likewise within the power of Congress. Citing *Chase National Bank* v. *United States*, 276 U. S. 327; *Reinecke* v. *Northern Trust Company*, 278 U. S. 339; *Gwinn* v. *Commissioner*, No. 31, October Term, 1932, decided December 5, 1932."

We submit that these cases support no such proposition. The basis for the tax in these cases was not the failure to exercise the power but the fact that decedent retained for himself until his death either an economic interest or the right to obtain it, so that an economic control for the settlor's benefit passed at death. Thus in the *Chase National Bank* case, he could until his death obtain for himself the proceeds of the insurance policies, or could borrow upon them. In the *Reinecke* case, he could until his death revoke the trusts and recover the property at will. In the *Tyler* case, he retained a very real and substantial use, enjoyment and benefit of the property until his death, whereupon the corresponding interest of the survivor was in effect doubled. The same consideration applies to *Gwinn* v. *Commissioner* (decided December 5, 1932) and *Third National Bank* v. *United States* (decided December 19, 1932). The case of *Corliss* v. *Bowers*, 281 U. S. 376, which the Government quotes at page 21 of its brief similarly involved the

case of a revocable trust, and the opinion clearly reveals that fact as the basis of the decision (p. 378).

In this case the decedent had transferred the property years before his death. At his death he had nothing but a power to alter the enjoyment of beneficiaries other than himself or his estate. He could not recall the property or its use or enjoyment for himself. At his death no interest was transferred from him to the beneficiaries. Their interests remained as before, except that a threat was removed. The situation resembled the case of a vested remainder liable to be divested upon the happening of an uncertain event.

At the time of his death, the relation of the decedent to the property was no different than it would have been if he had never owned the property and the power had been lodged in him by another owner by appropriate grant. And yet, upon the theory advanced by the Government, the failure of such a donee to exercise the power would be subject to tax.

II.

The Government stresses the contention that the transfers were "incomplete". But the emphasis is mainly directed to the possibility of variation among the interests of the beneficiaries. It ignores the fact that as to the *donor* the transfer *was complete;* never again could he possess or enjoy any part of the property. He had "finally denuded himself". There was nothing further to be transferred from him at death.

Here again the Government cites the cases above referred to, ignoring the substantial interests which the respective decedents had in each instance retained for their own use or enjoyment. Thus it is stated (Brief, p. 16):

> "The power retained by the decedent left the interests of the beneficiaries in the present case no more complete until the decedent's death than the interests

> of the beneficiaries of the 'two trusts' in *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339."

But in the *Reinecke* case, with respect to the "two trusts", the decedent reserved a power of revocation, so that at any time until his death he might have drawn back the entire property into his own possession. He had not "denuded himself."

Similarly the *Chase National Bank* case is quoted (Brief, p. 18). But the Court was there concerned with the power of the decedent at any time during his lifetime to possess himself of the entire surrender value of the insurance policies.

We submit that it is the certainty of the separation from the decedent during his lifetime and not the uncertainty of the interests of the beneficiaries, which is controlling in this case, involving a transfer tax on the estate of the decedent.

III.

The Government has devoted much space to an effort to prove that the trusts here in question were revocable, presumably in the hope of bringing them within the ruling as to the "two trusts" in the *Reinecke* case. It is therefore of importance that this point be determined as a preliminary consideration.

What is generally meant by the term "revocable"? Certainly not the mere right to alter the interests of beneficiaries. In the general acceptance of the term, it includes the right to repossess the trust property and, if desired, to wipe out the trust entirely. This was the character of the revocability under consideration in the *Reinecke* case.

In that conception, it is entirely clear that the original trusts made by this decedent in 1918 and 1919 were irrevocable. He reserved no power to revoke. The reserved

powers could not be construed as a power of revocation, for in fact they prohibit revocation thus:

> "* * * but this power to modify or alter is not intended and shall not be construed to include the right to the donor to make such modification or alteration in his own favor or in favor of his estate but shall apply only so far as the interests of third parties are concerned."

As pointed out at p. 34 of our original brief, it is well settled that transfers of this character are irrevocable and that attempted revocations are ineffectual.

The instrument of November 27, 1926, was therefore wholly ineffectual for that purpose and the new trust deed (Helen Porter Davisson Trust No. 3) executed upon that day conveyed nothing nor did it effect any transfer. At most, its effect was merely to modify the terms of the original Trusts 1 and 2, which otherwise continued in full force and effect. The Government has apparently elected to adopt a contrary view, and in the footnote at the bottom of p. 36 of its brief, the statement is made:

> "The trustee accepted it as a new trust and regarded the former trusts as terminated."

We find no warrant for this statement in the Record, but on the contrary it was testified on behalf of the Trustee (R., p. 81) that the Trustee did not redeliver any part of the trust property to the decedent and that "if Mr. Porter had handed me an instrument purporting to revoke the trust and demanding the return of the securities, I would not have delivered them to him."

That the Government does not rely too strongly upon this position is further evidenced by its labored effort to work out a theoretical possibility of revocation through the operation of the laws of the State of New York. We have already made reference to this at page 19 of our original brief and will not further burden the Court. Suffice it to say that the scheme involves the finding of what the Court

below termed a "facile beneficiary" who would conspire in advance to assist in terminating the trust, and thereby restore the trust property to the donor, in deliberate violation of his covenant not to exercise his reserved power in favor of himself.

We have merely to comment that none of the New York Appellate Division cases cited by the Government in support of this enterprise involves a state of facts in which the donor had excluded himself from any benefit through exercise of the power, and we question, as did the Court below, whether any Court would sustain such a fraud upon the express terms of the power.

With further reference to the subject of revocability, the following statement is made at page 35 of the Government's Brief:

> "Moreover, the construction advanced by the petitioners would make Section 302 (d) wholly meaningless, for trusts subject to a power of revocation are taxable under Section 302 (c). *Reinecke* v. *Northern Trust Co.*, 278 U. S. 339."

As a matter of fact, the Revenue Act of 1924, which included Section 302 (d), was approved on June 2, 1924. The decision in the *Reinecke* case which determined that revocable trusts were taxable under Section 401 (c) of the 1921 Act was not handed down till 1929, the decision of the Circuit Court of Appeals having been handed down in 1927. (24 Fed. [2nd] 91.) Hence, at the time Section 302 (d) was inserted in the Statute, it had not been held that revocable trusts were taxable.

IV.

The Government dismisses the retroactive feature of the case by reference to *Reinecke* v. *Northern Trust Company*, *Third National Bank* v. *White*, *Tyler* v. *United States*, and *Gwinn* v. *Commissioner*.

We repeat that in all these cases the decedent had retained until his death either a substantial economic use or enjoyment, or the right to repossess for himself use or enjoyment of the property. At his death, therefore, something actually passed which was an appropriate subject for a tax, even though the Statute was enacted after the execution of the trust instrument.

In the present case, the decedent had not only divested himself of the property but he had made it impossible to repossess the property either for himself or his estate. At his death there was no interest to pass, because he had "finally denuded himself". The only transfers *from him* were those made to the trustee prior to the enactment of the Statute. Nor was it possible for him to restore himself to a position where he could make provision for the subsequently enacted tax which would ultimately fall upon his estate. It is again urged that taxation under these conditions violates the constitutional provision.

CONCLUSION.

The decision of the Circuit Court of Appeals should be reversed.

Respectfully submitted,

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